



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

**Testimony of
the Honorable Hector V. Barreto
Administrator, US Small Business Administration
Reauthorization of SBA programs
United States Senate
Committee on Small Business and Entrepreneurship
April 26, 2006**

Chair Snowe, Ranking Member Kerry, Senators, thank you for inviting me to testify on the reauthorization of the Small Business Administration and its programs. Over the past four years SBA has dramatically increased its services to the small business community. Our loan programs have provided billions in additional funding for small businesses, and government contracts awarded to small businesses have steadily increased since 2001 to an all-time high. These are examples of what the SBA has accomplished since 2001 while, at the same time, showing fiscal restraint and responsibility. Our current reauthorization proposal reflects our commitment to continuing that success.

In general, the Administration proposes a few technical changes, the repeal of duplicative, unused or unnecessary programs, and a simple three year reauthorization of SBA programs with steady increases in the authorization levels for SBA's financial programs.

Legislation has been proposed to improve oversight and penalties for criminal acts, and to harmonize various statutes for clarity and consistency. However, SBA has proposed several more significant items that I would like to discuss in detail.

Administrative Fees for Loans over \$1 Million

SBA has proposed an administrative fee for loans over \$1 million which would affect only a small percentage of loans and would offset \$7 million in loan-making costs.

The Administration believes that a small business with the ability to take on a \$1 million loan should have the ability to cover this fee, which can be financed over the life of the loan. This fee proposal would apply to the 7(a), 504 and SBIC debenture programs.

Secondary Market Fee

SBA has proposed legislative language giving the SBA the authority to impose a secondary market fee in order to cover anticipated future costs of the "prompt payment" guaranty under section 5(g) of the Small Business Act.

SBA does not anticipate charging this fee in either fiscal years 2007 or 2008. However, this authority will enable SBA to cover the future subsidy cost of the guaranty without altering the pooling program in the secondary market.

Adjustments to the structure of secondary market pools have helped SBA cover the costs of the guaranty, but that is not a long term solution, and frequent changes create difficulties in the assembly and sale of loans in the secondary market.

CDC Review Fee/504 Program

SBA has proposed a conforming change for the 504, specifically a proposal to cover program oversight costs. The charge would authorize a fee designed solely to offset the costs of examinations, reviews and other lender oversight activities. This same statutory authority already exists in the 7(a) program.

Disaster Loans

As I testified at the budget hearing several weeks ago SBA is proposing an alteration in the structure of disaster loans. Absent legislative action the cost of disaster loans are expected to rise by 20 percent in fiscal year 2007. This is largely attributable to rising interest rates, a factor that SBA cannot control.

This proposal would continue to offer the current deeply- subsidized interest rate for the first five years when the disaster victim need the subsidy the most, and thereafter adjust the rate to that of an equivalent Treasury security determined at the time of loan closing, still a below market rate.

SBA is also exploring various changes to our delivery system for disaster loans. SBA's Office of Disaster Assistance has done an outstanding job in fiscal year 2006 approving nearly \$9 billion in overall disaster loans and processing over 300,000 applications twice as fast as we had during the Northridge earthquake.

Nevertheless, we can always strive to do better. With that in mind SBA has issued a Request for Information (RFI) to solicit suggestions from the private sector on how SBA can better deliver its services, particularly in extraordinary-disaster situations like Hurricane Katrina.

We are also proposing to allow Small Business Development Centers (SBDCs) to utilize existing portability grants to offer educational assistance to small businesses during major disasters. Extending Economic Injury Disaster Loans to qualifying Nonprofit organizations is also included in the proposal.

Legislative Proposals

Madame Chair, as your staff requested SBA has reviewed certain pending Senate legislation. Unfortunately, we have not had the opportunity to review all the bills that have been introduced. I would like to summarize our questions, concerns and comments about several of the pending bills, although of course we will be happy to work with the committee on the details.

S. 1603/ 7(a)

SBA has reviewed your bill Madame Chair, and we have the following comments. SBA supports the proposed National Preferred Lenders program. We have been working on a similar model through administrative efforts, but we would welcome enactment of statutory authority. This provision will relieve our lending partners, who often operate in several states, of the burden of duplicative applications and approvals. SBA also has no significant objection to an increase in the authorization level of the 7(a) program. With the implementation of zero subsidy, the program has the potential for growth and such an increase may be prudent.

SBA also has no opposition to applying the alternative size standard to 7(a) loans as proposed in S.1603. This standard has been used in the 504 and SBIC programs for several years, and is often a useful alternative to applying the NAICS codes.

SBA has some concerns regarding the proposal to increase the gross loan amount from \$2 million to \$3 million. As you know, the Administration has striven to expand the use of the 7(a) program by smaller borrowers, increasing our loans under \$200,000, and particularly our loans under \$50,000 dramatically. At the same time, while loans over \$1 million make up a small percentage of the 7(a) portfolio (roughly three percent), they represent twenty percent of loan dollar volume.

Some have argued that lower loan sizes may have a negative effect on recovery rates and that they reduce fee income, but that argument cuts both ways. A substantial increase in large loans creates an equivalent potential for a negative effect on program performance. It requires far fewer large loan defaults to create a significant increase in losses.

Compared to smaller loans, SBA has only limited information on the performance of larger loans in our portfolio, and until a few years ago there were very few such loans. SBA believes more study and analysis must be done, and once we have more experience with the performance of loans over \$1 million we can determine the feasibility of further increasing the loan amount for the 7(a) program.

S. 2162/CDCs

SBA is generally supportive of S.2162 and its goals. It provides helpful statutory language regarding the definition of a Certified Development Company (CDC), and clarification of the local development aspect of this program.

SBA supports the provision that authorizes CDCs to liquidate their own loans or to use the services of an approved outside contractor. This will provide more efficient and timely liquidation actions and will assist SBA in portfolio management. We look forward to working with the Committee to clarify and define some of the details.

However, SBA is concerned with the provision permitting persons to hold multiple directorships on the boards of CDCs in different areas. This language will tend to dilute the local aspect of the program. As S.2162 emphasizes, this is a local development program and SBA believes CDC directors should participate on a local basis.

SBA would also like to seek clarification on the application of Section 7 of S.2162 regarding the combination of public policy goals. SBA is concerned how the combination could or should be applied across different goals.

Finally, SBA has reservations about the provision permitting refinancing of certain amounts. SBA is concerned that refinancing of existing SBA loans with new SBA loans, which is currently prohibited, would be allowed under this provision.

S. 1923/SBICs

SBA has also reviewed S. 1923. While we tend to agree with the Congressional Budget Office (CBO) that this legislation would be considered a debt program covered by the Federal Credit Reform Act, we also agree with CBO that it would have a significant subsidy rate. While we have not created a subsidy model for the program proposed by S. 1923, we believe the CBO estimate that places the rate of about 20 percent to 25 percent is probable.

In order to achieve the zero subsidy rate specified in the legislation, the program would require significant upfront fees. SBA has not been able to analyze the effect on the subsidy rate that restricting the program to one tier of leverage would produce. We believe that it would reduce the subsidy rate, but without a new subsidy model we can not accurately estimate the effect. Creating a model would require significant time, and we received your inquiry only the week before last.

Furthermore, the Administration believes that there is significant private sector equity financing available. VentureExpert, using Moneytree data for FYs 2003 through 2005, reports that over \$9.5 billion was placed in investments ranging from \$500,000 to \$5,000,000.

Madame Chair, thank you again for inviting me to testify. Obviously, SBA's reauthorization covers the full spectrum of our many responsibilities and I have only touched on a few points. I look forward to your questions.